

Financial Markets



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Hopes of a New Year's rally reminiscent of January 1979 dimmed in the opening days of 1980. Political uncertainties were intensified by the bold Russian military advance into Afghanistan, which is likely to exacerbate already unstable political conditions throughout the Middle East. The ensuing negative investor sentiment that rippled throughout world financial markets sent the dollar plummeting to historic lows and briefly pushed the price of gold through the \$600 barrier. At home, bond prices turned down and, in the Treasury market, pushed the yield on Thursday's \$1.5 billion 15-year bond auction to a record average of 10.60%. That yield did produce some retail interest on Friday, and prices stabilized as the week ended.

The disturbing political developments in the Middle East clearly had a greater effect on the markets than did the accumulating evidence that 1980 will be the year the economy moved into a recession. The November dip in the index of leading indicators, off 1.3% after a similarly sharp fall in October, is the strongest signal yet from this statistic that a business downturn is in the making. December auto output remained in a slump, and continuing weakness in sales has prompted further layoffs in the auto industry. Nor do initial reports suggest that Christmas buying was strong enough to counter the underlying weakness in the consumer sector.

The recent moderation in money growth may also be a reflection of declining business activity. Since October 6 when the Federal Reserve announced new measures to curb monetary expansion, M₁ has increased only marginally, and M₂ growth has been about 5 1/2%, down considerably from the pre-October pace. But it is much too early for the Federal Open Market Committee to consider shifting policy gears when it meets on Wednesday. For one thing, despite the slower growth in the conventional monetary aggregates, there has still been no appreciable slowdown in total reserve expansion since the October moves, and the monetary base has shown signs of speeding up in recent weeks. Some moderation in reserves would seem a prerequisite to easing credit policy under a reserve-targeting policy approach.

More importantly, as Federal Reserve Chairman Paul Volcker emphasized again this week, the credibility of the U.S. inflation fighting effort remains on the line in the domestic and international credit markets. Until inflation shows signs of slowing—and to date it clearly hasn't—policy easing might be construed as a crack in the Fed's resolve, and so the credit authorities can be expected to resist the impulse to relax policy with the first signs of a softening economy. Rates will begin to decline as credit demand subsides in 1980, but the resultant downturn in rates is unlikely to be as pronounced as might ordinarily be expected.

Glenn C. Picou



Prime Lending Rate at Irving Trust Company Short-term loans to substantial depositors with highest credit rating.		1/4/80 (noon)	Week Ago	Year Ago
Effective since		15.25% 12/7/79	15.25%	11.75%
Discount Rate at Federal Reserve Bank.		12.00	12.00	9.50
Federal Funds		13.75	13.50	10.00
Repurchase Agreements		12.63	11.85	9.70
U.S. Treasury Issues - Yields				
Bills				
3 months		12.65	11.95	9.70
6 months		12.60	12.36	10.00
1 year.		11.75	11.89	10.45
Coupons				
2 years		11.42	11.34	9.85
4 years		10.63	10.58	9.37
7 years		10.59	10.34	9.17
10 years		10.59	10.41	9.10
Long Bond.		10.26	10.11	8.92
Negotiable Certificates of Deposit-Secondary Market				
1 month		13.40	13.35	10.30
3 months		13.60	13.55	10.65
6 months		13.70	13.65	11.30
1 year.		12.50	12.50	11.15
Bankers' Acceptances				
1 month		13.45	13.40	10.29
3 months		13.70	13.65	10.68
6 months		13.85	13.60	11.42
Eurodollar Deposits				
1 month		14.38	14.63	10.80
2 months		14.56	14.75	11.10
3 months		14.63	14.75	11.30
Commercial Paper - Prime Names				
Directly placed by:				
Finance Companies				
1 week		12.00	N/A	6.00
1 month.		13.25	13.50	10.13
3 months		12.00	12.00	10.00
Bank Holding Companies				
1 month.		13.38	13.55	10.13
Dealer Placed:				
3 months		13.30	13.50	10.45
New Aa Corporate Utility Bond		11.85	11.90	9.50
Tax Exempt				
6 month Project Notes.		5.60	6.10	5.40
12 month Project Notes.		N/A	N/A	5.50
20 year AAA Bond.		6.90	7.00	5.95

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

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